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SUBJECT: Thirty Years of Reform and Opening: Shantou - The SEZ That Was Left Behind (Part 1 of 2)

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¶1. (U) Summary: Despite its special economic zone (SEZ) status and natural advantages such as a seaport and a large overseas Chinese population, Shantou's economic performance over the last 30 years has lagged behind that of Guangdong Province as a whole. Shantou officials and academics say their city of five million people faces unique challenges: geographic isolation from the locus of provincial economic growth (the Pearl River Delta), cultural insularity, and a history of intellectual property rights (IPR) violations that have made some investors wary of committing resources there. They also concede that the development process, especially the tolerance of using counterfeit goods as an engine of growth, over the last few decades has at times been mismanaged. Still, they are cautiously optimistic about the region's future prospects. (Septel will examine some of the advantages Shantou has in moving forward.) End summary.

Potential Unrealized

¶2. (U) At the start of reform and opening thirty years ago, the city of Shantou in eastern Guangdong Province held significant promise. It was named one of the first five SEZs along with Shenzhen, Zhuhai, Xiamen and the island of Hainan. But Shantou has not lived up to the promise. It remains a third-tier city at best and its economic growth has lagged behind Guangdong Province as a whole. Over the last decade, Shantou's GDP growth rate has averaged just over nine percent, compared to Guangdong's 14 percent. Per capita income in Guangdong grew from 370 RMB (US\$54) in 1978 to 28,332 RMB (US\$4,166) in 2006. In contrast, during the same period, Shantou's per capita income went from 366 RMB (US\$53) to 14,872 RMB (US\$2,187), growing at half the speed as that of the Province.

Geographic Isolation - Planning for Failure?

¶3. (SBU) Shantou was chosen to be an SEZ in part because of its relatively isolated location and the presumed willingness of Chaoshan (Chaozhou-Shantou) people living abroad to provide investment funding (see para 6). However, the geographical distance from the Pearl River Delta has contributed to its lack of success compared to the other SEZs. "If the reform failed, it would not lead to any significant impact on the wider province", according to Wu Nansheng, former Guangdong (GD) Party Secretary. Liu Wenhua, Assistant Director of Shantou Bureau of Foreign Trade and Economic Cooperation (BOFTEC) told us that, situated more than 300 miles away from the PRD, Shantou's economy is virtually "cut off" from the

influences of major local economic centers, such as Guangzhou and Shenzhen. She called the city an "isolated economic island".

14. (SBU) In addition, Shenzhen, Zhuhai and Xiamen were chosen among the first SEZs, in part because of their proximity to Hong Kong, Macau and the Taiwan-controlled island of Jinmen, respectively. Shantou lacks this kind of geographic advantage. Still, Liu hopes that recent agreements, which open new channels for travel and commerce between the mainland and Taiwan, will provide opportunities for Shantou to establish itself as a major conduit for cross-Strait trade and investment. Comment: Liu did not provide specifics and it's unclear how Shantou would compete with other cities such as Xiamen, which already has well-developed ties to Taiwan. End Comment.

#### Cultural Ties: A Mixed Bag

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15. (SBU) Shantou's unique Chaoshan culture makes it difficult for outsiders to integrate and has in some ways been an impediment to economic development, said Liao Xiaoping, Deputy Director of Shantou DRC. The region has its own cuisine, music and a dialect that is unintelligible to the Pearl River Delta's Cantonese speakers. He told us that very few talented workers are willing to come to Shantou for this reason. Other SEZ cities, such as Shenzhen, were able to create their own progressive business cultures from a "clean slate," while Shantou is pushing against generations of local tradition, according to Liao.

16. (U) On the other hand, an academic contact said overseas Chinese with cultural ties to eastern Guangdong play an important role in the development process. This was one of the reasons the city was initially selected as an SEZ. Shantou claims that almost ten

percent (3.35 million) of overseas Chinese come from their city, providing a substantial pool of investment capital and remittances to the local economy. Shantou native, now Hong Kong tycoon and richest man in China, Li Ka Shing, donates and invests heavily in the city. He funds the prominent Shantou University (China's only privately-funded public university), which serves as the education center, with a thriving journalism school, for eastern Guangdong.

#### Learning from Past Mistakes

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17. (SBU) Lack of leadership, poor oversight, and lax enforcement of IPR helped stifle the city's innovation and economic growth, government and business contacts agree. BOFTEC Assistant Director Liu pointed out that the government did not aggressively expand Shantou's small SEZ (initially less than one square kilometer) to cover the city's entire urban area until 1991, ten years after the initial status was granted. In contrast, Shenzhen, Zhuhai and Xiamen all finished their geographic expansions within two years of establishment. In addition, she highlighted lax enforcement of tax, IPR and other economic regulations during the 1990s as factors that held back Shantou's development. Liu pointed out that a major government crackdown on these violations contributed to several years of relatively slow and even negative growth from 1999 to 2002.

The owner of a major glass factory in the city echoed Liu's comments, noting that manufacture of counterfeit goods and other economic crimes put the city on the wrong development track throughout the 1990s.

18. (SBU) Despite these setbacks, officials remain cautiously optimistic. During the past four years Shantou's economic growth has nearly kept pace with the province's, and for the first time in 10 years, officials proudly pointed out the city's 2008 growth rate of 10.8% is on track to outpace that of both the country and the province. Of course, it is unclear whether city fathers have given much consideration to the impact of the financial crisis on this optimistic scenario. (Septel will further examine the advantages Shantou officials and business leaders see moving forward.)

#### Comment - The Uneven Results of Reform and Opening

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19. (SBU) The city of Shantou has certainly fared better economically than many parts of China. But this rough-edged third-tier city

shows that there are even parts of coastal Guangdong province with economic advantages like an SEZ and strong connections to overseas Chinese that still have not realized all the benefits of 30 years of reform and opening. It's illustrative of the uneven distribution of prosperity that will continue to be a challenge for China's leaders.

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